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Dividend policy, ownership structure and corporate governance: An empirical analysis of Indonesian firms

Ronny Malavia Mardani[1*]

[1] Department of Management, Faculty of Economics and Business, University of Islam Malang, Indonesia
*Corresponding Author(s) Email: ronnymalavia_fe@unisma.ac.id

ABSTRACT

One of the essential aspects of corporate policy is the decision on dividend payments as this dividend policy affects the value of the company. This study aims to determine whether there is a possible association between dividend policy, ownership structure, and corporate governance of Indonesian financial firms. This study offers empirical evidence on the relationship between variables in the context of Indonesia, which is a frontier market. The sample includes financial firms listed on the Indonesia stock exchange during the period between 2011 and 2017. Data analysis techniques were performed by using ordinary least square regression. Based on the result of 242 observed data analyses, it was found that while managerial ownership has no significant but positive effect on the dividend payout ratio, institutional ownership has significant and negative effects on dividend policy for sample firms. This positive relationship reflects that increasing the percentage of managerial ownership at one particular point, will make managers think that there is no longer any benefit in increasing dividend payout. Moreover, the total number of directors has a significant negative effect on dividend payout and the percentages of an independent members of directors have a positive but not significant effect on dividend policy. This result reflects that the independent board has an essential role in directing management to protect stakeholders' interest in the company. The study also reclaimed that dividend policy is positively and significantly influenced by profitability but inversely proportional to capital structure.

Keywords: Dividend Policy; Ownership; Corporate Governance; Independent Board

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Introduction

Corporate finance is a subject that primarily addresses three fundamental issues that have generated debate for the last few decades which is financing, investment, and dividend-related decisions. Although the decision to pay dividends is one of the critical components of a company's success, Barros et al. (2020) and Dewasiri et al. (2019) claimed that there is no consensus on what factors determine dividend payout policy. Dividends may be defined as a fraction of a company's profit, paid by the company to its shareholders in proportion to their own as a reward for investing in the past. The term "the dividend policy" itself refers to the firm's payout strategy that management use to determine the frequency and magnitude of cash distributions to shareholders over time (Roy, 2015). A dividend policy could influence all of its stakeholders and the sustainable growth of the company. For example, a low dividend payment may make shareholders disgruntled, but a huge dividend payment could hinder the business to continue to grow (Juhandi et al., 2013; San Martin-Reyna & Duran-Encalada, 2015).

The dividend policy is a sensitive subject to cover. On the one hand, the dividends are viewed as the control mechanism of the directive, therefore it can be used to mitigate any agency-related issues that may arise in the future. On the other hand, the big shareholders may restrain dividend payouts and trigger agency conflicts by using their majority ownership to acquire resources for their advantage at the expense of the minority (Khan et al., 2022; Romadhon & Kusuma, 2020; San Martin-Reyna & Duran-Encalada, 2015; Trihermanto & Nainggolan, 2018). The agency conflict between majority and minority shareholders has commonly happened in emerging markets (Setiawan & Kee Phua, 2013). Therefore, the issue of good corporate governance mechanism implementation and ownership structure to decide dividend policy and to protect minority interests is widely discussed these days. Previous studies found that there is a clear association between dividend payment and ownership structure such as Abbadi et al. (2020) that revealed a significant positive correlation between institutional ownership and dividend yield, whereas foreign ownership is correlated to a low incidence of dividend payments, there's also no evidence to suggest that family ownership or state ownership affects dividend yield in Jordan listed firms, and Hasan et al. (2021) that concluded that government and institutional ownerships have a significant but negative effect on dividend payouts, whereas family and public ownerships have a significant but positive effect in Bangladesh. Moreover, Egri et al. (2004) found that the relationship between corporate governance and dividend payouts is limited depending on the mechanism of

protection both from the firm level and country level for investors. Baker et al. (2020), Pahi & Yadav (2019), and Romadhon & Kusuma (2020) added that the implementation of a good corporate governance system is covetable to prevent managers and/or majority shareholders' opportunistic behavior and strengthening the ability of managerial to enhances corporate earning quality.

Few studies investigate the effect of corporate governance and ownership structure on dividend policy based on local context, especially in an individual emerging country like Indonesia. For example, Setiawan & Kee Phua (2013) examined the relationship between corporate governance and dividend policy during the post-monetary crisis period in Indonesia, Imamah et al. (2019) investigated whether corporate governance, shariah law, and growth opportunities affect dividend policy in Indonesia context, Basri (2019), Duygun et al. (2018), and Moin et al. (2020) studied whether financial leverage, profitability, the growth of assets, and corporate ownership structure affect dividend policy of the Indonesian companies. However, most of the studies mentioned above have taken the dividend policy determinant of Indonesian firms separately. This study aims to examine, empirically, the relationship between dividend policy, corporate governance (with the proxy of board size and independent board), ownership structure (with the proxy of managerial and institutional ownership), profitability, and capital structure of the Indonesian companies into a single framework.

Literature Review

Dividend Policy and Ownership Structure

The dividend policy is the firm's management strategy to decide whether to distribute profits to shareholders as dividends or to keep them in reserve to fund new investments. The company always seeks an optimal dividend policy by balancing current dividends and ensuring sustainable growth to enhance corporate value (Meissner & Brigham, 2001). Egri et al. (2004) and Sawicki (2009) added that while in the US the debate over dividend policy has focused particularly on the reason why firms pay amounts of dividends, given that the tax disadvantage of dividends looks to be enormous, Renneboog & Trojanowski (2011) stated the discussion of the choice of the payout channel is considered as the most topic to discuss in Europe (dividend, repurchases, combination). In Asia, the discussion of dividend policy is mainly concerned with the role of the ownership structure, as family owners control the greater part of firms (Carney & Child, 2013; Claessens et al., 2000). Similarly, the proportion of family firms accounted for more than half of firms in Indonesia with the majority of them

tending to pay lower dividends and engage in expropriation to minority shareholders (as they favor controlling their resources for themselves) compared to state-holding firms, foreign firms, and similar type companies in Western Europe (Faccio et al., 2001; Setiawan et al., 2016). High ownership concentration, state involvement, and political connectedness of dividend policy regulation are just a few of Indonesia's agency problem distinctive characteristics.

Previous studies from Bokpin (2011), Lin et al. (2017), Mardani et al. (2018), Al-Najjar & Kilincarslan (2016), and Roy (2015) found that there is the relationship between the type of ownership (state and/or non-state, family and/or non-family, foreign and/or domestic investors, managerial and/or institutional), the proportion of shareholders ownership and dividend payout from various country of study. The study focuses on managerial and institutional ownership as the proxy of the type of ownership as the nature of the relationship between managerial and/or institutional ownership and dividends payout ratio may be more complex than previously assumed, and it also varies dramatically between enterprises with varying amounts of debt/financial limitations (Florackis et al., 2015). Therefore, in view of these, the proposed hypotheses can be seen below.

H_1: Managerial ownership is positively related to dividend policy in Indonesia.

H_2: Institutional ownership is negatively related to dividend policy in Indonesia.

Dividend Policy and Corporate Governance

In today’s business world, there are frequently conflicts of interest between insiders and outsiders, and those insiders that have more control of resources may utilize those against the interests of outside investors. For instance, insiders may plunder from companies, pay themselves excessive compensation, or make non-profitable investments (Imamah et al., 2019). A novel approach to evaluating the agency's argument for dividend policy is to analyze the relationship between dividend policy and corporate governance (CG) compliances. Corporate governance itself can be described as the system, policies, and procedures adopted by firms to manage businesses and protect shareholders' interests. While good corporate governance proved to be a critical success in organizational performance to pay higher dividends (Jiraporn et al., 2016; Pahi & Yadav, 2019), poor governance policies with concentrated ownership, low financial transparency, and low board effectiveness often increase the probability of individual default risk, thus, exaggerate the domino effect of credit defaults (Ruwani Fernando et al., 2021). Previous studies from five South East Asian countries namely Indonesia, Malaysia, Thailand, Hong Kong, and Singapore show that there

is an inverse relationship between corporate governance and dividend payout policy (Baker et al., 2020; Benjamin & Mat Zain, 2015; Sawicki, 2009; Setiawan & Kee Phua, 2013). Contradictory, Bokpin (2011), in his research on the Ghana Stock Exchange, found that corporate governance attributes such as board size and independent board composition had a positive effect on dividend performance. Consistent with Bokpin's findings, Abor & Fiador (2013), Al-Najjar & Kilincarslan (2016), Matitaputty & Davianti (2020), Setiawan & Kee Phua (2013) found a positive influence of board size on dividend policy. Also, the role of independent directors on the board proved significantly influence dividend payment as confirmed by Adjaoud & Ben-Amar, (2010), Roy, (2015), Thompson & Adasi Manu (2021), and Udin et al. (2017).

In view of these, neither developed countries nor emerging or developing countries have reached a consensus on how corporate governance and dividend policy are related. According to Baker et al. (2020), these inconsistent findings may occur due to the different settings and methodologies. Therefore, the study aims to clarify the relationship between corporate governance and dividend policy in the Indonesian context by using Bokpin's attributes.

H_3: There is a positive relationship between board size and dividend policy in Indonesia.

H_4: There is a positive relationship between the independent board and dividend policy in Indonesia.

The Determinant of Profitability and Capital Structure on Dividend Policy

The relationship between profitability and dividend policy begins with the findings of Lintner (1956). Profitability is one of the primary determinants of dividend payments. Tekin & Polat (2021) added that companies with a good level of profitability tend to increase their dividend to attract and signal their future profitability to their investors. In previous studies, most researchers found that profitability was positively related to dividend policy. Amidu & Abor (2006), Kumar (2003), and Mehar (2005) are among those who obtained evidence that profitability is positively related to dividend payout in their research. Consistent with previous studies, recent studies by Roy (2015) and Setiawan & Kee Phua (2013) also obtained evidence of a positive relationship between profitability and dividend policy.

H_5: There is a positive relationship between profitability and dividend policy in Indonesia.

However, profitability is not a single factor that can affect the decision-making of dividend payout. There are two theories considered by companies in making a financial decision which are the trade-off theory and the pecking order theory. Hang et al. (2018) argued that firm size and profitability will affect capital structure negatively under the

pecking order hypothesis, but favorably under the trade-off theory. According to the pecking order idea, profitable businesses tend to use their internal resources for funding, such as earnings rather than loans, when they require capital. As a result, the company's debt ratio will decrease as profitability increases. Kaźmierska-Jóźwiak (2015) also has a similar argument, the usage of the pecking order theory in formulating firm financial sources often ended with a negative relationship between profitability and leverage. More profitable firms acquire sufficient earnings and are better able to hold onto their earnings, which would pay fewer dividends. Therefore, the proposed hypotheses of the study are formulated as below.

H_6: Capital structure is negatively related to dividend policy in Indonesia.

Methods

The sample consisted of a financial firm on Indonesia Stock Exchange (IDX) that announced dividend payments. The sample period of the study is from 2011 to 2017. The financial firm selected as the study sample is a recommendation of a previous study by Setiawan & Kee Phua (2013). A total of 97 financial firms that listed in IDX in the period 2011 to 2017. Thus, out of 97 companies about 42 financial firms were dropped due to the lack of information (missing) on dividend payment reports. We also exclude the companies from empirical models that did not have continuous data on dividend payout ratio, the board profiles, and other control variables. The total firm-year observations of the study are 242 with Ordinary Least Square regression (OLS) analysis used to model and assess the hypotheses, and then robustness analyses are performed.

The dependent variable in the study is dividend policy measured by the proxy variable of dividend payout ratio (DPR). The dividend payout ratio is the ratio of the total amount of dividends paid out to shareholders relative to the net income of the company (Chen et al., 2013; Li, 2016). It is the percentage of earnings paid to shareholders in dividends. The dividend payout ratio indicates how much money a company is returning to shareholders versus how much it is keeping on hand to reinvest in growth, pay off debt, or add to cash reserves (retained earnings). Furthermore, managerial ownership, institutional ownership, the board size, and independent board were selected as independent variables of the study controlled by profitability and capital structure.

Managerial ownership often sees as the proxy of managerial power to gain more rent *vis-â-vis* institutional investors (Janakiraman et al., 2010). While managerial ownership can be measured by the percentages of the number of ordinary shares owned by managers (executive directors on the board of directors) with the number of shares outstanding (Oktavian &

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Ahmar, 2019; Shan et al., 2019), institutional ownership is the proportion of shares owned by institutions such as banks, insurance companies, investment firms, mutual and pension funds, and others, over the number of shares outstanding (Ali & Hashmi, 2018; Oktavian & Ahmar, 2019). On the other hand, board size and independent board are defined as the total number of directors on the board and the proportion of independent directors on the board following Roy's (2015) study. The control variables of profitability and capital structure were measured by using the proxy of return on equity known as ROA (the ratio between net income and total asset) and debt-equity ratio known as DER (the ratio between total liabilities and shareholder's equity) following Barros et al. (2021), ElBannan (2020), Ngo et al. (2020), and Roy (2015) studies.

Lastly, to examine the association between ownership, corporate governance, profitability, and capital structure dividend, we employ the regression model as shown in the following Model 1.

$$DPR_{it} = \alpha + \beta 1MNG_{it} + \beta 2INT_{it} + \beta 3BSZ_{it} + \beta 4IDB_{it} + \beta 5ROA_{it} + \beta 6DER_{it} + \varepsilon \quad (1)$$

Where:

DPR_{it} : Dividend payout ratio of firms i in the year of t;

MNG_{it} : Financial capital of firms i in the year of t;

INT_{it} : Financial constraints of firms i in the year of t;

BSZ_{it} : Board size of firms i in the year of t;

IDB_{it} : The number of an independent board of firms i in the year of t;

ROA_{it} : Return on asset of firms i in the year of t;

DER_{it} : Debt to equity ratio of firms i in the year of t;

α : Constant;

β : Coefficient;

ε : Residual Error.

Result and Discussion

In Table 1, descriptive statistics were presented. Among 242 sample studies, the institutional type of ownership is higher than managerial ownership. The proportion of institutional ownership within our financial firm samples of study is in the range of 0 to 97.3 percent with an average of 47.1 percent compared to managerial ownership which has 0 to 48 percent and an average of 2.8 percent. Moreover, our sample study tends to have a smaller board size with an average of 14 and a range of 7 to 25. The proportion of independent

directors on board in the study is in the range of 0.100 to 0.330 percent with an average of 19.8 percent. The number of independent directors on the board was far below the best practices of IDX as it is required to have a minimum of 30% of independent directors in the board composition. Therefore, based on the descriptive explanation of board size and independent board that represents corporate governance indices, it can be concluded that that the corporate governance of the financial firms in our study is still relatively weak, which needs to be a concern for the sampled financial companies in this study. Lastly, the descriptive result of Table 1 shows that ROA is in the range of -0.060 to 0.210 with an average of 0.045, which indicates that the average financial firm's profitability is meager. On the other hand, DER is in the range of 0.010 to 13.240 with an average of 4.606, which shows that the financial firm has very different characteristics from other field companies (more rely on debt financing).

Table 1. Descriptive Statistics

Variables	Minimum	Maximum	Mean	Std. Deviation
MNG	0.000	0.480	0.028	0.102
INT	0.000	0.973	0.471	0.359
BSZ	7.000	25.000	14.260	5.166
IDB	0.100	0.330	0.198	0.061
ROA	-0.060	0.210	0.045	0.047
DER	0.010	13.240	4.606	3.107

Table 2. Correlation Matrix

Variables	MNG	INT	BSZ	IDB	ROA	DER	DPR
MNG	1						
INT	-.263**	1					
BSZ	-.225**	-.044	1				
IDB	-.074	.048	.007	1			
ROA	.118	-.044	-.327**	.117	1		
DER	-.153*	-.089	.515**	-.115	-.447**	1	
DPR	.103	-.119	-.249**	.030	.207**	-.256**	1

*) Correlation is significant at the 0.05 level
**) Correlation is significant at the 0.01 level

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Based on Table 2 of the correlation matrix, the results show that managerial ownership has a significant negative correlation with both institutional ownership, the board size, and capital structure (proxied by debt-equity ratio). While the negative correlation between managerial and institutional ownership implying that the substitute correlation between variables, the other negative correlation indicates that companies tend to use smaller boards and decrease their level of leverage when managerial and/or institutional shares increases. The size of the board positively correlated with an independent board and capital structure, signifying that the smaller board of the object study tends to have a smaller proportion of independent board and amount of debt, and *vice versa*. Contradictory, board size is negatively correlated with profitability (proxied by ROA) and dividend payout, indicating that the greater the size of the board will reduce the company's profitability and ability to pay dividends.

Table 2 also shows that the number of independent directors on boards is negatively correlated with profitability and amount of debt but correlated positively with dividend payouts. The majority of financial firms listed in the IDX stock market are small and/or medium-sized firms suggesting that it could be difficult for these businesses to set up genuinely independent boards. Koerniadi & Rad (2014) added that the presence of independent directors on the board is negatively related to firm value when they are in the majority of the board, such characteristics where the theory of stewardship is likely to hold. Moreover, profitability is negatively related to the capital structure but positively associated with dividend payout, signifying that a greater amount of profitability will cause a decreasing level of debt and higher dividend payment. Furthermore, capital structure has a negative correlation with dividend payout, which indicates that the higher the level of leverage the company has, the lower its ability to pay dividends.

Table 3. Regression Results

Model	Coefficient	t-Statistics	Decision
MNG -> DPR	0,002	0,013	H_1 Rejected
INT -> DPR	-0,071	-2,107*	H_2 Accepted
BSZ -> DPR	-0,005	-2,013*	H_3 Rejected
IDB -> DPR	0,032	0,171	H_4 Accepted
ROA -> DPR	0,328	1,180	H_5 Accepted
DER -> DPR	-0,009	-1,985*	H_6 Accepted

*) Significant at 5 percent

Furthermore, to check the standard assumptions, several additional tests were run. The Jarque-Bera test assured the normality of the distribution of the residuals. The *p*-value of the Jarque-Bera test result obtained is 0.224 which is higher than 0.05, therefore it can be concluded that the sample data is normally distributed. We also tested multicollinearity issues within variables by using correlation coefficient and variance inflation factor (VIF). In general, a VIF above 4 or tolerance below 0.25 denotes the possibility of multicollinearity (Groebner et al., 2011). In this study, the VIF of all independent variables is in the range of 1.053 to 1.657, which confirms our conclusion that there is no multicollinearity. Finally, to examine whether the regression model has heteroscedasticity and/or autocorrelation issues, the White's test and the Breusch-Godfrey Serial Correlation LM were performed. The result of both test statistics is 0.320 and 0.115 for a 99.5% confidence level, therefore it can be concluded that there are no heteroscedasticity and autocorrelation issues within the model.

Table 3 shows that managerial ownership and board size have no significant and positive effect on dividend payouts. These findings thus rejected the proposed hypotheses 1 and 3. The financial firm's ownership characteristics listed in the Indonesia Stock Exchange are very different from other sectors, such as manufacturing, which are often used as research objects by previous researchers. There are only 4 out of 55 financial firms that are used as the sample of the study used managerial ownership in their share ownership structure. These different characteristic make the results of this study differs from previous studies, especially related to share ownership by managers. Allam (2018) and Rostami (2022) added that the more managerial ownership structure in the company, the higher the power to control resources and self-desire to gain more personal benefit and deceive shareholder interest. Moreover. The insignificant effect of board size in the study suggests that a small board may not be able to carry out the expected governance responsibilities (Nazar, 2021; Roy, 2015; Sapuan et al., 2021), and often resulted in a higher amount of dividend payment (Qureshi et al., 2018).

Institutional ownership has a significant and negative impact on dividend payout, which indicates that an increase in the percentage of institutional ownership will reduce the interest of companies to distribute dividends. These results are consistent with the findings of Al-Najjar & Kilincarslan (2016), Amidu & Abor (2006), Kumar (2003), Mardani et al. (2018), and Roy (2015). Therefore, the proposed hypothesis 2 which states that institutional ownership is negatively related to dividend payout can be accepted. The following results show that board independence is positively associated with dividend payout, but not in a significant way. The result of the study supports Bokpin's (2011) and Roy's (2015) findings on the direction of the relationship between the independent directors on the board and

dividend payout. This result reflects that the independent board has an essential role in directing management to protect various stakeholders in the company. Thus, hypothesis 4 in the study states that the independent board is positively related to dividend payout is acceptable. Furthermore, while profitability (proxied by ROA) has no significant and positive effect on dividend payout, capital structure (proxied by DER) has a significant and negative impact on dividend payout, therefore the proposed hypotheses 5 and 6 can be accepted. This means that although there is an insignificant effect of profitability on dividend payout, the positive correlation between variables signifies that firms that is experiences greater profitability will pay dividends highly (Amidu & Abor, 2006; Kumar, 2003; Mehar, 2005; Roy, 2015; Setiawan & Kee Phua, 2013). The result also suggests that the higher the amount of debt will decrease the payment of dividends (Bokpin, 2011; Hang et al., 2018; Kaźmierska-Jóźwiak, 2015; Roy, 2015).

Conclusion and Suggestion

The difference in the company's characteristics used as a research sample significantly affects the study results. In this study, a financial firm is used as an object of research. Based on the result of 242 observed data analyses for seven years, it was found that while managerial ownership has no significant but positive effect on the dividend payout ratio, institutional ownership has a significant and negative effect on dividend policy. The positive relationship between managerial ownership and dividend policy reflects that the higher the proportion of managerial ownership within the company will cause a higher self-desire to gain more personal benefit and deceive shareholder interest that may end with the thinking that there is no longer any benefit in increasing dividend payout. Moreover, the total number of directors has a significant negative effect on dividend payout and the percentages of an independent members of directors have a positive but not significant effect on dividend policy. This insignificant result of board independence reflects that the independent board has an essential role in directing management to protect stakeholders' interest in the company. The study also reclaimed that dividend policy is positively and significantly influenced by profitability but inversely proportional to capital structure.

One of the limitations of the study is the low number of financial companies in the managerial ownership structure, implicated in the result of the study that can’t be generalized. On the other hand, it has been described previously that the implementation of corporate governance in financial companies is in the weak category. In order to overcome this constraint, it is recommended that in future studies, corporate governance be measured using

the Corporate Governance Index (CGI). It is hoped that a more detailed picture of the ownership structure, shareholder roles, and responsibilities of the board of commissioners will be obtained.

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